IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, ET AL.,	§	
	§	
Plaintiffs,	§	
	§	
VS.	§	
	§	CIVIL ACTION NO. H-01-3624
ENRON CORP., ET AL.,	§	AND CONSOLIDATED CASES
	§	
Defendants.	§	
	§	
	§	

DEFENDANT ALLIANCE CAPITAL MANAGEMENT L.P.'S MEMORANDUM IN SUPPORT OF ITS MOTION TO DISMISS PURSUANT TO RULE 12(b)(6)

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Defendant Alliance Capital Management L.P. ("Alliance Capital") submits this memorandum in support of its motion, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, to dismiss plaintiffs' claim allegedly arising under Section 15 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77o.[1]

PRELIMINARY STATEMENT

The massive complaint in this action asserts only a single claim against Alliance Capital, and that claim is legally deficient on its face. Following the collapse of Enron Corporation ("Enron"), plaintiffs obviously have made a strenuous effort to include as many solvent defendants as possible in this litigation.[2] But in the case of Alliance Capital, that effort lacks any valid basis in law or fact.

In stark contrast to the claims alleged against other defendants in this action, the near 500-page Consolidated Complaint does not assert any direct claim against Alliance Capital. Alliance Capital, for example, is not alleged to have made any false or misleading statement about Enron, or to have assisted others in so doing. Indeed, the only cause of action asserted against Alliance Capital derives from plaintiffs' claim against defendant Frank Savage ("Savage"), a respected business leader who is an outside director on Enron's board. Plaintiffs claim that Savage violated Section 11 of the 1933 Act by signing a registration statement for a

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[1] Paragraph 83(ee) of the Consolidated Complaint states that "Alliance [Capital] is sued as a controlling person of Savage and is liable under §§11 and 15 of the 1933 Act." (Compl. ¶ 83(ee)) However, because Alliance Capital clearly does not fall within any of the categories of defendants enumerated as potentially liable under Section 11 (*e.g.*, persons who sign the registration statement, directors, issuers, underwriters, etc.), Alliance Capital cannot be liable under Section 11. *See* 15 U.S.C. §77k. We assume plaintiffs' statement is simply a consequence of inartful pleading. However, to the extent that plaintiffs are attempting to assert a Section 11 claim against Alliance Capital, that claim must be dismissed.

single offering of Enron convertible notes which plaintiffs allege contained misrepresentations or omissions. (Compl. ¶¶ 83(ee), 1006). In an attempt to pursue Alliance Capital as a potential deep pocket, plaintiffs now allege that because Savage was a director of Alliance Capital and an officer of an Alliance Capital affiliate, Alliance Capital should be liable as a "controlling person" under Section 15 of the 1933 Act. However, as set forth below, the mere fact of Savage's affiliation with Alliance Capital is insufficient as a matter of law to make Alliance Capital a "controlling person" with respect to Savage's service as an outside director on the board of an unaffiliated corporation. And importantly, plaintiffs have pleaded no other facts which would bring Alliance Capital within the scope of Section 15. In fact, were plaintiffs' scant allegations sufficient to support a claim under Section 15, every company would face vicarious liability for the acts of any officer or employee who served on another company's board of directors. This is not the purpose of Section 15. Accordingly, the Consolidated Complaint as to Alliance Capital should be dismissed.

THE ALLEGATIONS AS TO SAVAGE AND ALLIANCE CAPITAL

Plaintiffs' claim against Alliance Capital is under the "controlling person" provisions of Section 15. As noted in the Consolidated Complaint (at 3, n.1) no allegations of fraud are made against either Alliance Capital or Savage. Plaintiffs allege that Savage, an outside director of Enron from 1999 through 2001 (Compl. ¶ 83(ee)), signed a "false and misleading" Enron registration statement "which was used to sell [certain convertible notes] as to which § 11 claims under the 1933 Act are asserted." Plaintiff Staro Asset Management LLC ("Staro") alleges that it purchased some of these convertible notes and "has suffered substantial damages as a result

(continued...)

[2] Although this action was commenced on October 22, 2001, Alliance Capital was first named as a defendant in the Consolidated Complaint, which was served on April 10, 2002.

thereof." (Compl. ¶ 81(e)). Liability is asserted against Alliance Capital only "as a controlling person of Savage." The Consolidated Complaint states (¶ 83(ee)) that "since [19]95, Savage has been Chairman of Alliance Capital Management International (a division of defendant Alliance Capital Management L.P.) [and] Savage was also a director of defendant Alliance Capital Management L.P.. . . ."[3] Apparently on the basis of these assertions, the Consolidated Complaint makes the leap of logic that "Alliance controlled and directed Savage in his activities as a director of Enron."[4]

SUMMARY OF ARGUMENT

Plaintiffs' Section 15 claim against Alliance Capital should be dismissed for numerous reasons. First, Section 15 was never intended to impose liability on an entity merely because it employed a person who also independently acted as an outside director of an unaffiliated company. Second, plaintiffs have failed to adequately plead that Alliance Capital had the power to control Savage's actions in connection with his decision as an outside director of Enron to sign a registration statement issued by Enron. Finally, if Section 15 were construed to impose

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[3] Although this allegation is accepted as true for purposes of the present motion under Rule 12(b)(6), we note that Savage actually was not a director of Alliance Capital Management L.P. Rather, he was on the board of Alliance Capital Management Corporation, the general partner of Alliance Capital Management L.P.

[4] In another pleading deficiency, the Consolidated Complaint does not specify which plaintiff is asserting a Section 15 claim against Alliance Capital and should be dismissed for that reason. Presumably, it must be Staro, which is the only party asserting a Section 11 claim against Savage. Notably, Staro does not allege that it purchased the convertible notes in the offering, and thus Staro may lack standing to assert a claim under Section 11, in which event the secondary claim under Section 15 would also necessarily fail. *See, e.g., Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990). In fact, if plaintiffs' Section 11 claims against Savage fail for any reason (*e.g.*, Savage's 12(b)(6) motion is granted), the Section 15 claim against Alliance Capital must also be dismissed. In any event, it is not necessary to resolve these issues for purposes of the present motion, because the Section 15 claim is fatally defective in other respects.

employer liability on such a basis, corporations would have a powerful incentive to prohibit their executives from serving as independent directors of other companies.

ARGUMENT

I. Plaintiffs Have Failed To Allege Any Facts Sufficient To Bring Alliance Capital Within The Scope Of Section 15.

A. The Applicable Standards

Section 15 states, in relevant part:

> Every person who . . . controls any person liable under Section 11 or 12, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

As the Fifth Circuit has noted, "Congress's specific purpose in enacting § 15 was to impose liability upon persons who controlled corporations committing violations of the Securities Act but who might attempt to evade liability under common law principles by utilizing 'dummies' that would act in their place and under their control." *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1115 (5th Cir. 1980) (emphasis added). This conclusion is supported by the legislative history of Section 15. *See* Senate Report No. 47, 73rd Cong., 1st Sess. at 5 (1933) (stating that "[i]n order to aid in preventing directors from evading the liabilities incident to signing the registration statement, there are provisions governing "dummy" directors"). In *SEC v. Mgmt. Dynamics, Inc.*, 515 F.2d 801 (2d Cir. 1975), the Second Circuit reached the same conclusion, and specifically rejected the suggestion that Section 15 (and its counterpart under the 1934 Act, Section 20) were intended as broad employer liability provisions:

> The legislative history of § 20(a), and of its analogue in the Securities Act of 1933, § 15, gives no indication that Congress intended them to govern employer liability. Section 15 had its genesis in the concern that directors would attempt to evade liability under the registration provisions by utilizing "dummy" directors to act in their stead. And § 20(a) was consciously modelled [sic] after § 15 of the 1933 Act. As Thomas C. Corcoran, one of the authors of the 1934 Act, testified before the Senate Committee: . . . The purpose is to prevent evasion of the provisions of the section by organizing dummies who will undertake the actual things forbidden by the section.

Id. at 812 (citations omitted). Thus, a company's CEO, for example, could not avoid liability for false and misleading statements in the company's registration statement simply by directing others to sign the registration statement for her. Section 15 claims therefore are typically asserted against the officers of a company who are in a position to direct the activities of or statements made by that company. *See, e.g., G.A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 958 (5th Cir. 1981) (finding officer to be a control person of the company because he was not only a "24% stockholder and an officer and director, but was . . . involved in the day-to-day coordination of the loan gathering"); *Dartley v. Ergobilt, Inc.*, NO. CIV. A. 398CV1442M, 2001 WL 313964 at *1 (N.D. Tex. Mar. 29, 2001) (finding that the "fourth largest" shareholder of a company, who was not an officer, director, employee or consultant of the company, did not participate in the day to day operations of the company, but had the right to appoint one of eight directors on the company's board, was not a controlling person of the company). Section 15 operates on the premise that a company can act only through or at the direction of its officers or directors, and therefore those individuals may properly be held liable for the acts of that company. *See In re Paracelsus Corp. Sec. Litig.*, 6 F. Supp. 2d 626 (S.D. Tex. 1998).

The "burden of establishing control is on the plaintiff." *Thompson*, 636 F.2d at 958 (5th Cir. 1981). In order to support liability under Section 15, a plaintiff must establish at a minimum

that the "controlling person" actually possessed the power to control and direct the person primarily liable with respect to the activities complained of. *See Paracelsus*, 6 F. Supp. 2d at 633 ("To establish a *prima facie* case of a Section 15 violation, a plaintiff must show that the defendant at least had power to control the 'controlled person' in the specific transaction that is alleged as a violation, and possibly, although the Fifth Circuit has not definitively so held, that the defendant actually exercised control over the operations of the controlled person"). While courts in the Fifth Circuit are divided as to whether the controlling person must actually have *exerted* control in the specific transaction at issue,[5] Section 15 liability clearly requires a showing that it had the power to do so. *See, e.g., Abbott v. Equity Group, Inc.*, 2 F.3d 613, 620 (5th Cir. 1993).

B. Plaintiffs' Allegations Do Not Comply With The Applicable Standards

Plaintiffs, in alleging that Alliance Capital controlled an individual director of Enron, a non-affiliated company, have failed to plead sufficient facts demonstrating that Alliance Capital had the power to control Savage's actions as a fiduciary of Enron. Plaintiffs have not, of course, met their pleading burden merely by making the conclusory assertion (Compl. ¶ 83 (ee)) that "Alliance controlled and directed Savage in his activities as a director of Enron." On a motion to dismiss, the court will accept as true "the well-pleaded factual allegations" of a complaint, but not mere "conclusions." *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994) (stating that the Court would "not accept as true conclusory allegations or unwarranted

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[5] *Compare G.A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 957 (5th Cir. 1981), with *Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 509-510 (5th Cir. 1990); *see In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 869 (S.D. Tex. 2001) (construing *Abbot* to require "power" to control, but not actual "exercise of the power").

deductions of fact"); *In re Netsolve, Inc. Sec. Litig.*, 185 F. Supp. 2d 684, 692 (W.D. Tex. 2001). Even under the liberal pleading standards of the Federal Rules, plaintiffs cannot state a sufficient claim merely by parroting the language of the applicable statute, without any specific allegations of fact. *See, e.g., Elliot v. Foufas*, 867 F.2d 877, 880-81 (5th Cir. 1989) (plaintiffs "must plead specific facts, not mere conclusory allegations"); *Guidry v. Bank of LaPlace*, 954 F.2d 278, 281 (5th Cir. 1992) (stating that "'[c]onclusory allegations and unwarranted deductions of fact are not admitted as true' by a motion to dismiss"); *Stewart Glass & Mirror, Inc. v. U.S.A. Glas, Inc.*, 940 F. Supp. 1026, 1031 (E.D. Tex. 1996) (stating that "[a] plaintiff . . . must allege specific facts, not conclusory allegations"). The requirement of some factual allegations beyond the merely conclusory is necessary "to prevent costly discovery on claims with no underlying factual or legal basis." *Migdal v. Rowe Price-Fleming Int'l*, 248 F.3d 321, 326 (4th Cir. 2001). Although plaintiffs "need not specify in exact detail every possible theory of recovery," plaintiffs are required to "give the defendant fair notice of what [plaintiffs'] claim is and the grounds upon which it rests." *Thrift v. Hubbard*, 44 F.3d 348, 356 (5th Cir. 1995) (emphasis added). Even under the liberal provisions of Rule 8(a), more is required than "the bald statement by plaintiff[s] that [they have] a valid claim of some type against defendant." 5A Wright & Miller, Federal Practice and Procedure, § 1357 at 318 (2nd Ed. 1990).

The only factual assertion offered as a basis for plaintiffs' Section 15 claim is the statement that Savage was an employee and a director of Alliance Capital entities. However, the Section 11 claim against Savage (which must itself be well-pleaded in order to provide a predicate for any alleged liability of Alliance Capital) is not based on any act Savage performed as an Alliance Capital employee, or on his service on the board of Alliance Capital. On the contrary, the underlying Section 11 allegations relate exclusively to Savage's alleged activities as

an outside director on the Board of Enron. We have located no authority which would impose "controlling person" liability on that basis alone, and such a result would be contrary to the intent and purpose of the statute.

Moreover, Section 15 specifically provides that if a "controlling person had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist," Section 15 liability will not attach. 15 U.S.C. § 77o. As the Fifth Circuit has noted, this "good faith defense" provided under Section 15 "made explicit Congress's intention of imposing liability under the controlling persons provisions only on the basis of a failure to exercise due care." *Paul F. Newton & Co.*, 630 F.2d at 1116 (5th Cir. 1980). While an entity may have a duty of care to supervise its employees within the scope of their employment, it clearly has no such duty with respect to an employee's outside activities, such as serving as an outside director on the board of an unaffiliated corporation. Quite simply, Alliance Capital could not violate Section 15 because it had no statutory or other duty of care with respect to Savage's actions as an outside director of Enron. *See generally Sennott v. Rodman & Renshaw*, 474 F.2d 32, 39-40 (7th Cir. 1973) (in directing dismissal of a claim brought under Section 20(a) of the 1934 Act, the court stated that a company's "duty to control its partners and agents, as well as its past employees . . . extends only to transactions with or by these parties where [the company] itself [is] involved . . . . To extend it further would be to impose liability upon [a company] for virtually any act of its past or present employees and partners regardless of how remote and unrelated that act might be to [that company]").

Even if a corporation could exert some degree of control over a person concerning actions within the scope of his employment, it can not reasonably be presumed to control the

employee's independent outside activities, such as serving on the board of another corporation. To establish a Section 15 violation in the Fifth Circuit, "a plaintiff must show that the defendant at least had power to control the 'controlled person' in the specific transaction that is alleged as a violation." *Paracelsus*, 6 F. Supp. 2d at 633 (emphasis supplied). Here, in contrast, there are no specific, fact-based allegations that Alliance Capital had the power to make Savage sign the registration statement at issue. Indeed, fundamental allegations are non-existent. "Who" at Alliance Capital had the power to control Savage's acts with respect to Enron? "Alliance Capital," the partnership, plainly could not do anything except through the actions of an individual. "How" did Alliance Capital control Savage's actions? The absence of these basic allegations belies a legally sufficient claim under Section 15. "Conclusory allegations in a complaint, if they stand alone, are a danger sign that the plaintiff is engaged in a fishing expedition." *DM Research, Inc. v. Coll. of Am. Pathologists*, 170 F.3d 53, 55 (1st Cir. 1999); *see also Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d 278, 284 (5th Cir. 1993) ("conclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to prevent a motion to dismiss").

Nor can a valid Section 15 claim be based upon the fact that, in addition to his employment, Savage served as a director of Alliance Capital Management Corporation. While directors under certain circumstances may be controlling persons under Section 15, there is no authority for the proposition that a director, merely by virtue of holding that position, is a controlled person of the corporation whose affairs he oversees.

Only two other allegations of the Consolidated Complaint are arguably relevant to the Section 15 claim, and neither is sufficient to state a cause of action. The Consolidated Complaint asserts, in the barest conclusory terms and with no allegations of supporting fact, that "Savage

sat on Enron's board to protect Alliance's interest and so Alliance would receive the benefits of what Savage learned as a director of Enron and a member of its Finance Committee." (Compl. ¶83(ee)). No facts are alleged as to any specific manner in which Savage is claimed to have "protect[ed] Alliance's interest," or as to any "benefits" Alliance is claimed to have received from Savage's membership on the Enron board. Such "[c]onclusory allegations and unwarranted deductions of fact are not admitted as true" on a motion to dismiss, and are not sufficient to resist such a motion. *Stewart Glass & Mirror*, 940 F. Supp. at 1031 (E.D. Tex. 1996) (citing *Guidry v. Bank of LaPlace*, 954 F.2d 278, 281 (5th Cir. 1992)); *see also Associated Builders, Inc. v. Alabama Power Company*, 505 F.2d 97, 100 (5th Cir. 1974).

Equally insufficient is the allegation (Compl. ¶88(ee)) that "Alliance (and Savage) had a huge motive to keep Enron stock trading at very high levels." The test of controlling person status under Section 15 is not "motive" to control, but "power" to control. *Abbott*, 2 F.3d at 620 (emphasis in original); *see also Dennis*, 918 F.2d at 509; *Thompson*, 636 F.2d at 957-958.

C. Imposing Liability On Alliance Capital Based On Plaintiffs' Allegations Would Be Contrary To Public Policy

Finally, attributing "controlling person" status to a corporation or partnership with respect to an employee's service as outside director of an unaffiliated corporation, in addition to lacking any basis in the statute or the relevant case law, would be contrary to public policy. If plaintiffs' allegations were legally sufficient to state a claim, any company that owned stock (in its pension plan, asset portfolio, etc.) of another company would be deemed to have a "motive" to control, and therefore the power to control, any officer or employee sitting on such other company's board. Faced with the prospect of open-ended, potentially huge liability and litigation costs, corporations would have a strong incentive simply to prohibit their executives from serving as

independent directors of other companies. Even in the absence of such a prohibition, many executives would undoubtedly be deterred from accepting outside directorships at the risk of exposing their own employers to large potential liability and expenses. The resulting void of highly qualified outside directors, who play a valuable role as "independent watchdogs" and "supply an independent check on management," *see Burks v. Lasker*, 441 U.S. 471, 484 (1979),[6] would surely not be in the public interest.

II. Dismissal Of The Section 11 Claim Against Savage Would Also Require Dismissal Of The Section 15 Claim Against Alliance Capital.

As noted above (p.4, n.4), if the Section 11 claim against Savage is dismissed for any reason, pursuant to any of the various pending motions or otherwise, the secondary claim under Section 15 against Alliance Capital must also fail as a matter of law. *See, e.g., Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990).

CONCLUSION

In their effort to maximize the number of solvent defendants in this litigation, plaintiffs have attempted to stretch Section 15 beyond the limits imposed by statutory language, judicial authority, and common sense. That attempt should be rejected. For the reasons set forth above, the Consolidated Complaint as to Alliance Capital should be dismissed.

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[6] *See also In re Baldwin-United Corp.*, 43 B.R. 443 (S.D. Ohio 1984), where the Securities and Exchange Commission filed an amicus brief stating "that it believes that outside directors should be encouraged to serve on the boards of directors of publicly-held corporations. In the Commission's view, outside directors provide important protections for public investors in corporations generally and particularly where companies are financially troubled."

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the Defendant Alliance Capital Management, L.P.'s Memorandum in Support of its Motion to Dismiss Pursuant to Rule 12(b)(6) has been served on all counsel pursuant to the Court's April 10, 2002 Order on this 8th day of May, 2002.

Ronald E. Cook

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, ET AL.,	§	
	§	
Plaintiffs,	§	
V.	§	CIVIL ACTION NO. H-01-3624
	§	AND CONSOLIDATED CASES
ENRON CORPORATION, ET AL.,	§	
	§	
Defendants.	§	

ORDER

On this ____ day of _____, 2002, came on for consideration the Motion of Defendant Alliance Capital Management, L.P. to dismiss the Plaintiffs' Consolidated Complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure; and the Court, having considered the Motion and all responses and replies filed to the Motion, is of the opinion that the Motion should be GRANTED; accordingly, it is

ORDERED that the Plaintiffs' Consolidated Complaint for Violation of the Securities Laws as to Plaintiffs' claims against Alliance Capital Management, L.P. is dismissed.

SIGNED at Houston, Texas on this ____ day of _____, 2002.

_____
Melinda Harmon
United States District Judge

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MARK NEWBY, ET AL.,	§	
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Melinda Harmon
United States District Judge